RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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July 2, DJIA 796.99; PTI 1286; A-D Ratio –27.30
July 9, DJIA 814.12; PTI 1286; A-D Ratio –27.24

THE PICTURE: The Commerce Department's "leading indicators" have risen three months in a row–from March through June. But on June 18 the D-J Industrial Average violated its March low of 795.47, thereby re-confirming the primary bear market. What's happening? Is the economy (via the Commerce Department's indicators) leading the stock market out of the bear trend? If so, it will be doing it for the first time.

On July 7 my Primary Trend Index (PTI) sank to a new bear market low of 1278. This was 232 points below its June 23, 1981 bull market high of 1510. Despite the new low in the PTI, despite the newly re-confirmed bear market, hopes have been running high in Washington. Two weeks ago Administration spokesmen announced that with three successive up-ticks in the lead indicators, the recession can be considered–over.

My own inclination is to doubt the optimistic forecasts coming from our nation's leading politicians. After thirty years of watching the interplay of the stock market and the economy, I have learned to trust the stock market more than the economic forecasts. In the past, the stock market has tended to hit bottom and turn up a few months to as much as a year ahead of the economy. With the leading economic indicators turning up in March and the stock market hitting new lows in June, I am none too sanguine about an end to the recession here in mid-1982.

All right, how about the stock market itself? Could the market have recorded a major bottom in June, or is it in the process of forming a major bottom here in July? Of course, where Wall Street is concerned anything can happen. But I remain skeptical.

FRONT PAGE COMMENT: With the new tax cuts, Americans will find trivial amounts added to their payrolls, amounts like $4, $8, or $12. But all such "gifts" are an illusion. The fact is that Federal spending was $731 billion in 1982 and it is slated to rise to $795 billion in 1983. According to the authoritative *Schroder Report* (by Santow and Griggs) the 1983 federal deficit is slated to be $140 billion. States the report, "If the budget unfolds as we expect, it will be disgraceful."

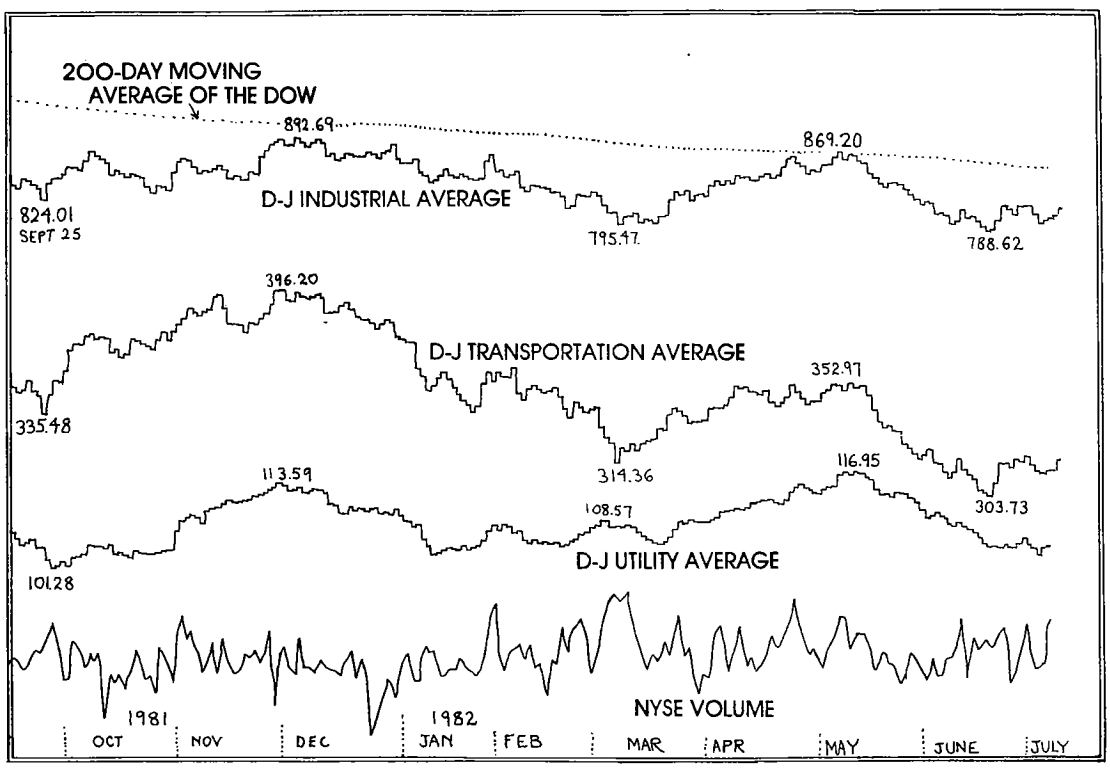
In the meantime, the Senate Finance Committee is trying to raise $100 billion in new taxes through fiscal 1985. The new tax boosts will be meaningful–and painful. The profligate and never-ending spending binge by Congress is slowly, but surely, sapping the strength of the US economy. Only one thing will end the assault on the pocketbooks of the American people and corporations. That will be a collapse of the markets. Example: look what has happened to the oil and energy stocks–all prime targets for Congressional taxes (with new taxes being planned). Coming target: the rich–via new restrictions on professional pension plans.

during the general run of a bear market (and this has certainly been the case up to now), everything, yes EVERYTHING is swept to lower levels in the final bear panic.

How does this fit into today's market? The fact is that this bear market has been very reluctant to form a major low here in 1982. How do we know? We see it in the gentle slope of the 21-day moving average of the PTI (see page 3). We see it in selective weakness in stocks (many stocks are still near their highs). And we see it in the absence of a final downward spike

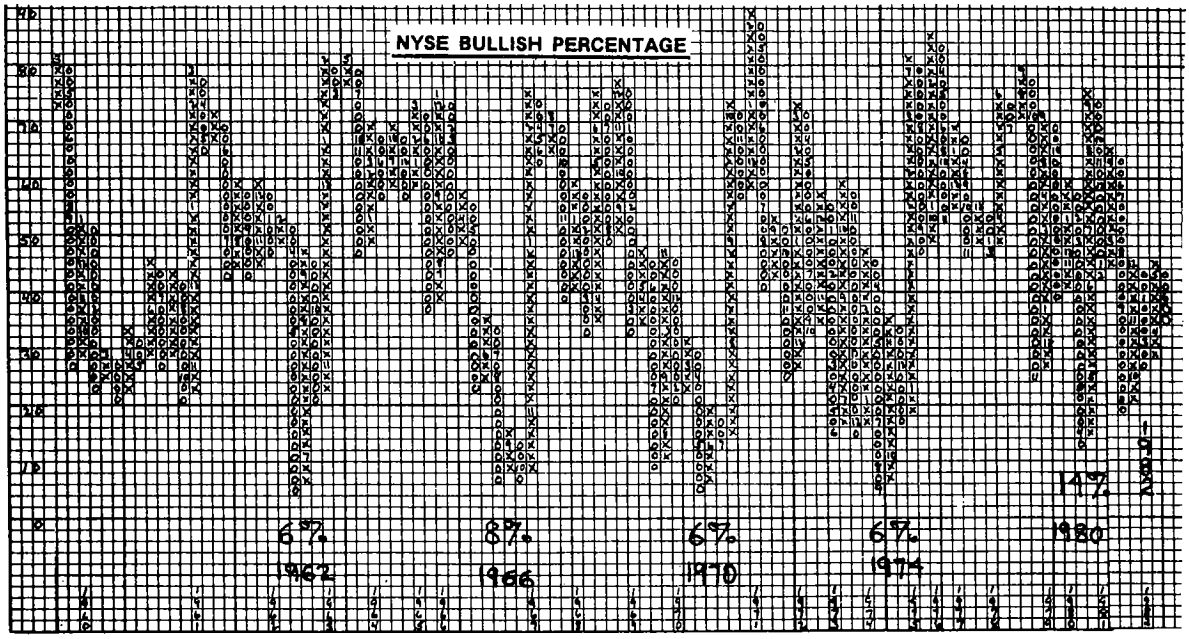
There's something eerie about this market, something strange and "uncomfortable." Week after week the majority of stocks slip lower. Week after week (eight out of the last ten weeks) the advance-decline line goes down. From all appearances I'd say there is steady, insistent, programmed selling in this market. The declines are dragging and dull, but the rallies are halted almost immediately with carloads of stocks for sale.

It is worth noting that the great majority of primary bear markets end with a final downside washout, a *non-selective* smash to new lows that usually takes ALL stocks with it. Although there may be many individual stock holdouts



in the averages (such as the selling panic spikes of 1966, 1970, or 1974).

We also see it in the percentage of stocks that are in bullish trends on the NYSE. The page 2 chart (courtesy of Chartcraft, Larchmont, NY) shows the percentage of all NYSE issues in bullish trends going back to 1960. Note that the market tends to top out when 80% or more of all stocks are bullish. But at important bottoms this chart is even more accurate. It shows us that at major bottoms since 1960, 8% or less of the NYSE issues re- mained bullish.



For instance, at the 1960 bottom only 6% of all NYSE issues remained in bullish trends. At the 1966 bottom only 8% of the stocks were bullish. At the 1970 bottom 6% of the NYSE issues remained bullish. And again in 1974 only 6% were bullish.

In April, 1980, the bullish percentage got down to 14%, still short of a fully over-sold condition. But most significant–here in 1982 the lowest bullish percentage we have reached was 28% in March. What can we make of this?

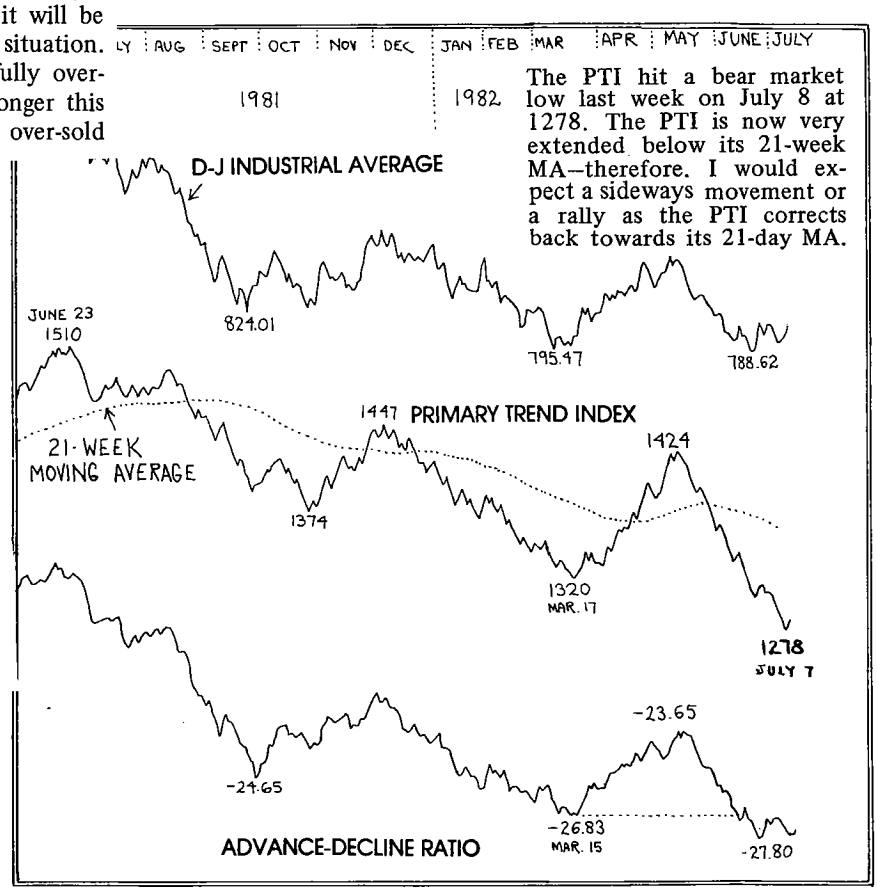
My interpretation is simply that we have not reached a major bottom. If the market attempts to rally from here, it will be a rally in a bear market following a semi-oversold situation. The fact is that it has been 8 years since the last fully over-sold low on the NYSE, and my feeling is that the longer this condition lasts, the more drastic will be the ultimate over-sold bottom.

If you look through a chart book you will note that many stock groups have had disastrous declines in this bear market (oils, steels, savings & loans, autos, farm equipment, copper, gold, etc.) while other groups have held up rather well (auto parts, beverages, foods, motion pictures, retail stores, tobacco, toys and games, etc.).

This market is not going to produce a classic bear market bottom until we see that final, non-selective plunge in which almost all stocks and groups go down together. Will this happen again, or is it a phenomenon of the past? In my opinion, it will occur again–and probably sometime between now and mid-1983. And as I've said before, the longer the time lag, the more drastic the final bottom. But until that final low appears, buying stocks will be dangerous and ultimately costly. When the final bottom of this bear market arrives, it will take all your guts and will power to move into the market and buy today's "bargains."

PRIMARY TREND INDEX (PTI): For the benefit of newer subscribers, the PTI constitutes an excellent instrument for tracking the underlying trend of the market.

A few observations and rules pertain to the PTI:
(1) Any persistent move by the PTI will, in time, take the stock market with it.
(2) Non-confirmation between the PTI and the major averages often precede important reversals.
(3) The PTI tends to be stronger than the averages. Therefore, repeated penetrations by the PTI in a given direction (even though unconfirmed by the averages) will ultimately take the market in the direction of the PTI.
(4) You don't have to be invested with the PTI (you can always

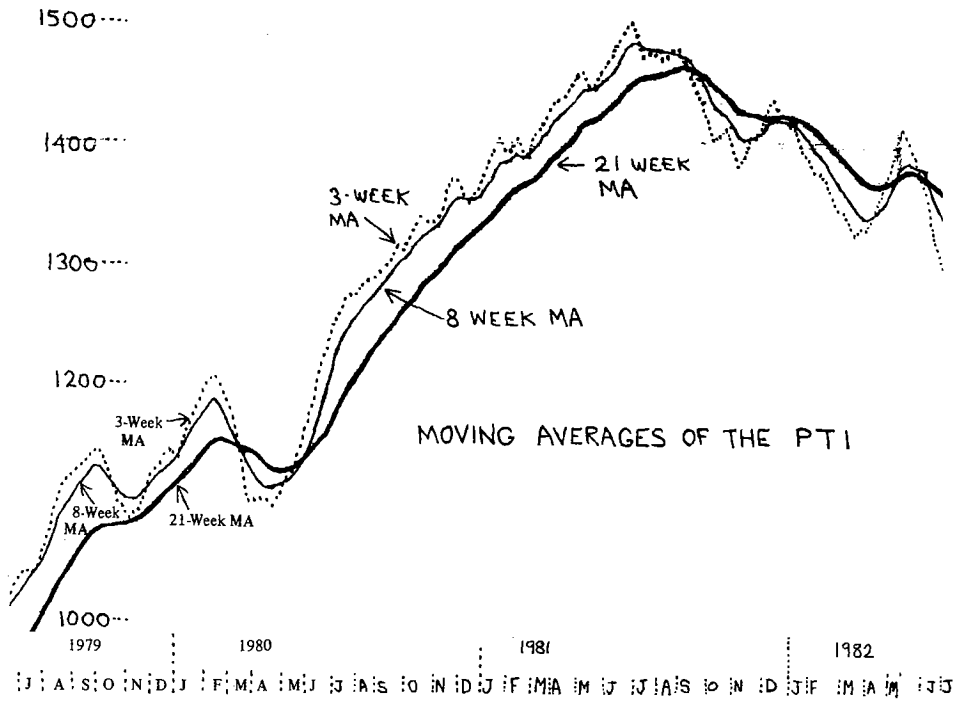


The PTI hit a bear market low last week on July 8 at 1278. The PTI is now very extended below its 21-week MA–therefore. I would expect a sideways movement or a rally as the PTI corrects back towards its 21-day MA.

skip the move), but NEVER be invested against the PTI. Investing or trading against the PTI is almost always costly.

In order to help me identify the PTI trend, I have for years run three moving averages of the PTI. I run a very sensitive 3-week MA, an intermediate term 8-week MA and a longer term 21-week MA. The critical relationship here is that position of the 8-week MA above or below the 21-week MA.

Major reversals are signalled by the 8-week MA rising above the 21-week MA or sinking below the 21-week MA. The important question following a crossing is always–was the crossing a whipsaw, or was the crossing a genuine reversal of the trend? There is no sure way of answering this (if I could answer that question I would be the richest man alive). But I have found, as a rule, that whipsaws are usually followed within three months by re-crossings in the original direction.



A very simple way of tracking the PTI is to watch the direction and pattern of the 21-week MA. The 21-week MA turned down in September, 1981, and it has been heading generally down ever since. However, note that the angle of ascent has been rather leisurely--and this offers food for thought. It tells me that the decline in the PTI since September, 1981, has not been as powerful as the advance from 1980 to late-1981. And that could be significant. Ultimately, this decline in the PTI will either pick up steam on the downside or reverse. And that's something I'm watching closely as this bear market drags on.

CYCLES: Ever since World War 11 the market has been subject to the 4-year (some insist it's a 4.5-year) cycle. This cycle is probably a function of the 4-year Presidential election, but election or not, the 4-year cycle was a regular occurrence from 1949 to 1974. Around the mid-1970s every analyst, market writer and trader became an expert on the 4-year cycle. The result, of course, is that the cycle became rather hazy and difficult to identify.

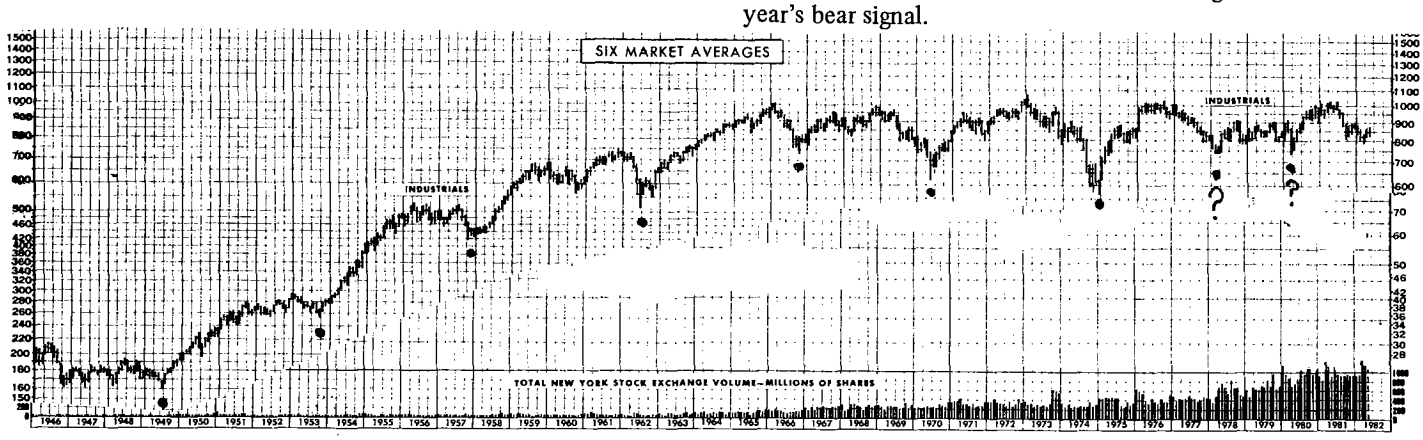
The chart below (courtesy Security Research, 208 Newbury St., Boston, Mass. 02116) depicts the 4-year cycle going back to 1946. Following the very dramatic 1974 bottom, the cycle becomes deceptive. In early 1978 we have a pseudo-bottom, but as you can see on the chart the '78 bottom did not develop the usual downward spike of previous cycle bottoms. As if to make up for this omission, we saw another minor plunge in early-1980, but here again the market failed to develop a major cyclical bottom.

Now we are in 1982 (8 years after 1974), and I am wondering whether the "long lost major bottom" may not appear in late-1982. Or is the market going to continue to toy with us, perhaps holding off until 1983 or 1984 before giving us the long awaited major bottom?

* *

So much for the 4-year cycle. For the nearer term, remember the bull phase of my 233-day cycle is due to top out in late-July or very early August. Then this cycle will be in its bear phase through October. So far, the bullish phase of the 233-day cycle (March through the end of July) has been exceptionally weak. That makes me wonder what will happen when the bear phase takes over starting in a few weeks.

INVESTMENT POSITION: My work indicates that a primary bear market is still in progress. But the situation is not without its bright spots. Bright spots–what are they? (1) Like almost all primary bear markets, this one will probably end by providing us with a great buy area for common stocks. But in order to take advantage of such a buy area, we will need cash. With this in mind, we have been collecting cash ever since last year's bear signal.



(2) The other bright spot is that for those with cash, this is one of the most profitable bear markets in history. The reason, of course, is that safe Treasury bills have been yielding 12% to 14%. With that kind of yield, investors can wait forever and not feel any pain (particularly as inflation winds down and the *real* return on T-bills pushes into the 8% or better area).

For those who are impatient, here are some interesting statistics (from E.F. Hutton, no less). Going back 12 cycles to 1949, an investor would have made an average of 12% buying three months ahead of the final bottom, he would have averaged 27% if he had bought at the bottom, and he would have averaged 23% if he had bought three months after the bottom (based on S & P 500). Lesson is, don't jump the gun; it can be expensive.

NOTES & QUOTES: American Standard, one of the nation's largest suppliers of plumbing fixtures, announced last week that its earnings were down 78% for the second quarter. It blamed the drop on "a recession the likes of which we've never seen." Of course, preceding the collapse in American Standard's earnings was a housing boom, the likes of which we have never seen before–and may never see again.

The building boom was predicated on a remarkable mixture: (1) low interest rates and very low real interest rates, (2) rampant inflation, driving the price of homes ever higher, (3) a federal policy of easy availability of money, (4) deduction of interest costs in financing housing, (5) a mad bank scramble to lend money to builders, (6) years of high employment and a sentiment among the young that "everyone" has a right to own his own home.

YEAR	PURCHASE PRICE	INTEREST RATE	DOWN PAYMENT	INTEREST EXPENSE	PRICE AT SALE	NET PROFIT
1974	$40,700	9%	$8,100	$2,900	$48,900	$3,300
1975	46,900	9%	9,400	3,400	57,200	6,900
1976	57,200	9%	11,400	4,100	74,700	13,400
1977	74,700	9%	14,800	5,400	91,500	11,400
1978	91,500	10%	18,300	7,300	111,400	12,600
1979	111,400	11%	22,300	9,800	124,100	2,900
1980	124,100	12%	24,800	11,900	132,000	-4,000
1981	132,000	13%*	26,400	13,700	132,000	-13,700

But now the arithmetic (among other things) has changed. This breakdown (from the LA Times) shows the median price of a single family home in Southern California and the profit (or loss) that a hypothetical family would have shown if they had bought a house at the beginning of any given year and sold it at the end of the year. The chart shows that the profit peak occurred in 1976 at $13,400. By 1981 the buyer-seller would be showing a fat $13,700 loss for his transaction. Conclusion: the boom in housing is OVER.

* *

Interesting facts dept.: In the 1970s the US created 20 million in new jobs. But only 5% were in manufacturing while almost 90% were in information and knowledge. In 1981 NYCs largest export was legal services, which edged out apparel. In 1800 90% of the people in the US were engaged in agriculture, producing 100% of US food needs. Today 3% of the population is in agriculture, producing 120% of our food needs.

* *

Sign of the Times Dept.: In 1973 the Coast Guard seized a total of six ships containing narcotics. Last year they seized 164. The marijuana the Coast Guard took in on those 164 ships had a street value of $1.7 billion, close to the Coast Guard's entire budget.

* *

Soak the rich? Is this where the big tax pickings are? According to the Tax Foundation, in 1979 there were 1.4 million tax returns in the high 50% bracket. These 50% bracket people paid a total of $18.2 billion in taxes out of the total income. If ALL the money paid by these people was taxed away, says the Foundation, the Government would only have taken in $10.8 billion more. Do you know how long this $10.8 billion would have lasted the government? Just a little more than a week. In case you weren't aware of it, our government is now spending $1.4 billion a day!

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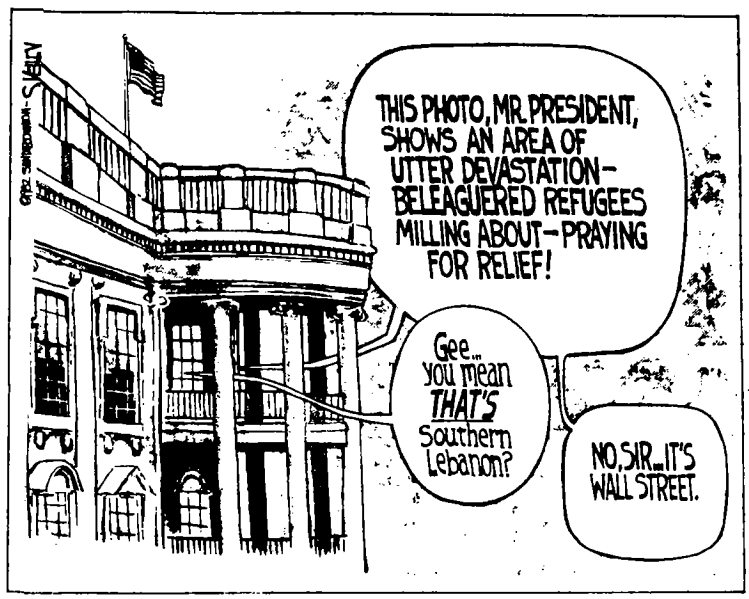
Question: when the cartoonists make fun of Wall Street's bear market, is it time for the market to get off its knees and rally? Answer: Yeah.


THIS PHOTO, MR. PRESIDENT, SHOWS AN AREA OF UTTER DEVASTATION – BELEAGUERED REFUGEES MILLING ABOUT – PRAYING FOR RELIEF!
Gee... you mean THAT'S Southern Lebanon?
NO, SIR... IT'S WALL STREET.

* *

The "flat rate" income tax is creating quite a stir today, and many (including this writer) hope that flat rate isn't simply this month's new buzz word. In my considered opinion, only one thing will usher in the flat rate tax. And that is the hope that a flat rate tax would bring in A LOT MORE MONEY to the Treasury. And it would. The biggest obstacle to a flat rate tax, of course, would be the massive "tax industry" which makes a fat living from taxes. This includes accountants, tax lawyers, real estate interests (via the interest rate deductions), tax shelter-connected industries, etc.

However, I believe that all this would be overcome if Washington believes it can take in more money via the flat rate tax. As the squeeze on tax receipts continues and intensifies, as Washington becomes desperate to take in more money, the flat rate tax will loom ever larger. More power to it–I'm all for it.

* *

About 5 years ago I flew up to Vancouver to see my friends, Harry Browne and Harry Schultz. I remember a breakfast that Paula and I had at a small Canadian eatery. The bill came to $11. I said to Paula, "This is ridiculous. We could get better breakfasts in the states for 25% to 40% less. Prices in Canada are absurd, and the Canadian dollar is going to go."

At that time the Canadian dollar was selling at about $1.03. Since then the Canadian economy and its dollar has collapsed (the Canadian dollar is now worth about $.76). Furthermore, the new Canadian budget is a disaster. With a GNP that is one tenth the size of the US GNP, the new Trudeau deficit is $19.6 billion. That's comparable to a $195 billion US deficit. Of course, the US might hit that figure by 1985, so it's hard to tell who's craziest on the North American continent–Mexico, Canada, or the US. Take your choice.

* *

People ask me what's happening to real estate here in San Diego (which a few years ago was the hottest real estate market in the nation). Well, things have slowed down. And it's getting kind of hard to sell homes and condos here in San Diego. This clip from our local paper gives you a glimpse of the kind of troubles developers have been having in the Southland.

San Antonio Enterprises has announced a price reduction of more than $100,000 on its Moonlight Bay condominium units one block north of San Diego Bay on Kellogg Avenue in the Point Loma area of San Diego.

John Bardacos said new prices are $170,000 to $430,000 with 12 1/4% financing for the first three years.

"We've adjusted our prices to sell immediately," he said. "We'd like to have full occupancy by summer."

The one-bedroom through three-bedroom units range from 1,050 to more than 2,000 square feet and offer views of the harbor and city skyline.

Penthouse and two-story townhome units also are available in the project.

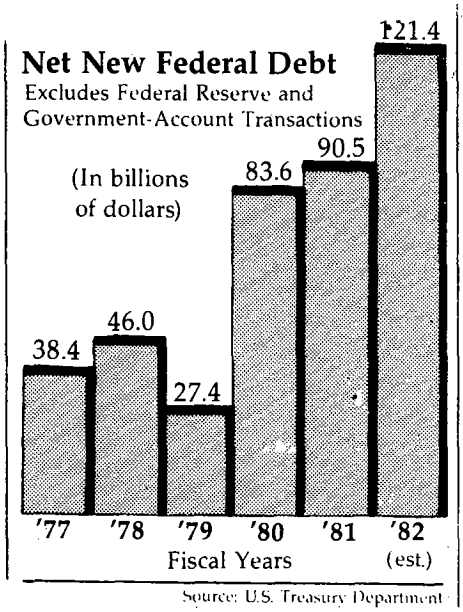
* *

From the reading room. Note on the Government Finances statistical box that the Federal debt has now pushed to about one trillion eighty billion dollars. Interest on the debt for the first eight months of the fiscal year was $74 billion, indicating that the full year's interest cost will be about $112 billion or almost TEN BILLION A MONTH! Talk about a nation eating itself up alive . . . . .

Government Finances

WASHINGTON (AP) – Here are figures on government spending and debt (last six digits are omitted). The government's fiscal year runs from Oct. 1 through Sept. 30.

Total public debt July 1	1,079,921 ←
Interest on public debt May	9,075
Interest fiscal year thru May	74,397
Projected deficit fiscal 1982	100,495
Projected deficit fiscal 1983	101,908
Actual deficit fiscal 1981	57,932
Receipts fiscal year thru May	402,120
Receipts period last year	373,066
Outlays fiscal year thru May	483,259
Outlays period last year	437,234
Gold for May	11,149



Deficit of $104 Billion May Be Underestimate

WASHINGTON, June 24 (AP) — The record deficit of $104 billion Congress is forecasting for the 1983 fiscal year may seem small compared with the deficit the Government actually runs up.

In each of the last three years, the initial budget plan approved by Congress was optimistic when it came to forecasting the deficit for the following fiscal year.

In mid-1979, Congress approved a 1980 budget plan calling for a $23 billion deficit. The actual figure was $60 billion, the second largest deficit ever.

In 1980, after rejecting Jimmy Carter's red-ink budget for 1981, Congress wrote a whole new plan that promised the first balanced budget in a dozen years. The actual deficit was $58 billion.

Last year, Congress accepted Ronald Reagan's budget-cutting and tax-cutting plan and predicted a $38 billion deficit for the 1982 fiscal year, which began Oct. 1, 1981. Now, the Reagan Administration is predicting an actual deficit of $100 billion.

As for the 1983 budget, many forecasters think the real deficit will be in the neighborhood of $150 billion, assuming interest rates come down, the economy returns to health and Congress enacts some of its planned savings. But if the economy remains weak, the deficit could swell above $175 billion.

One reason for the poor deficit estimates seems to be that politicians tend to be optimists when it comes to predicting the economy's future and their own ability to hold down spending.

LONDON (DJ) – Henry Kaufman, chief economist at Salomon Brothers, is sticking with his predictions of rising U.S. interest rates and forecast that the federal funds rate would be up to 17% within the next six months, according to an interview in the Investors Chronicle.

The Investors Chronicle quoted Kaufman as saying that "long-term interest rates will go higher and will go back to the highs of September and October of last year."

He noted that long-term government securities, currently about 14 1/8%, were then around 15 1/4%.

"Short term interest rates will also rise irregularly, though perhaps they may not go back to the highs of last year," Kaufman said.

GOLD: There are five most interesting "pluses" in the current gold picture. The first is the short interest situation in the gold stocks. According to *Legg Maison's* Paul Montgomery, "the current level of our precious metals stocks short interest ratio is 9.44, an all-time high. The previous all-time high on this ratio was 7.65

in February, 1977, just as a major bull market in precious metal stocks got underway".

The second item is the 5.5 year silver cycle which is due to bottom somewhere within the next few months (if not now). The third item (see chart) is that my gold momentum chart (13-week rate of change) has just broken its third descending trendline, a trendline ("fanline") drawn from the January, 1980 peak in gold momentum (this peak in momentum was set at 200). Note also that each of the lows in gold momentum since early-1980 was higher than the preceding. In a phrase, the downside momentum in gold appears to have ended.

The fourth item is that spot gold has now pushed above its near-term or 5-week moving average. The 5-week MA of gold stands at 315, the 13-week MA for gold stands at 325, and the 50-week (primary) MA stands at 377. Under the moving average study, the first buying signal would be a rise by the 5-week MA ABOVE the 13-week MA.

The fifth item is that gold seems to have tested the critical 300 level rather thoroughly and rather successfully. The 300 level (see last Letter) currently intersects the major trendline for gold.

On July 8 spot gold jumped to the 323 area, and on July 9 gold exploded to just under 350. "Too fast," you say, "bear market action," you sneer. Maybe so, maybe so, but gold has knocked a lot of good men out of the market during its 1980-82 decline, and it's kind of late to be a big bear on gold. You'll note in my recent Letters that I've been dropping my bear stance towards gold. I'm now turning from neutral to neutral-bullish on the yellow metal.

What to do: I feel that if you don't have any commitments in gold are now warranted. This is (as I explained in the last letter) a "just in case" situation . Just in case there is a world credit crisis, you should own some gold now. Just in case a new bull market in gold is beginning, you should own some gold now. How much gold? I can't tell you, I can only decide how much I am willing to own. But initial commitments in krugerrands, maple leafs, double eagles are now warranted. Put them on "long term hold."

LATE NOTES: As stated in the last Letter, I believe Paul Volcker and the Fed are panicking at what they see occurring in the economy. Should the Fed hold fast or should it pump? The answer is emerging, and it's pump, make money available, accommodate. To put it in a nutshell, the Fed has turned expansionary (despite a drop in the Fed funds, the Fed has been doing "repos" and expanding reserves day after day).

The result–a rally in stocks and bonds. Gold, seeing the Fed's intentions, has shot up 15% in two days.

When the markets rally, many amateur investors get that sinking feeling that "maybe I missed the boat." But that's exactly the way the market wants you to feel. If a bear market didn't rally, if it didn't lure new players into the game every few months or so, then the bear would have his whole romp in a matter of a few months. And it just doesn't work that way.

Veteran investors ALL possess one characteristic–and it is patience. They have the ability to wait until they feel that "the time is right." The bear knows this, and he tries to thwart the investor. "You missed it," growls the bear, "you're too late." "It'll never come," "You're a fool," snarls the bear.

How do I see the whole picture? I see almost all the markets as extended on the downside and in need of rallying action. There's too much bearishness, too many puts and shorts out, too much pessimism on gold, stocks, commodities.The bear is going back into its lair for a while. Do I still think we're in a bear market? You bet I do. But consider this–the advance-decline ratio has been down an amazing 8 out of the last 10 weeks. That is concentrated, persistent bearish action. After the bear has you in his grip for 8 out of 10 weeks he has to relax his hold a bit–he has to ease up. And that's what we're seeing now (except for gold, which could–just could be starting a primary bull move.)

NEXT MAILING: July 28